No. 2512

United States
Circuit Court of Appeals
For the Ninth Circuit

EDWARD H. CHAVELLE, as Trustee in Bankruptcy of WASHINGTON STEEL & BOLT COMPANY, a corporation, Bankrupt,

Appellant,

vs.

THE WASHINGTON TRUST COMPANY, a Corporation,

Appellee,

and

THE WASHINGTON TRUST COMPANY, a Corporation,

Appellant,

vs.

WASHINGTON STEEL & BOLT COMPANY, a Corporation, Bankrupt, and EDWARD H. CHAVELLE, as Trustee in Bankruptcy of WASHINGTON STEEL & BOLT COMPANY, a Corporation,

Appellees,

In the Matter of WASHINGTON STEEL & BOLT COMPANY, a Corporation, Bankrupt.

Petiton for Rehearing

J. W. RUSSELL,
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CO-OPERATIVE PRINTING CO., 1519 First Ave., SEATTLE

To
UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT, and

To HON. WILLIAM B. GILBERT,
HON. ERSKINE M. ROSS,
HON. CHARLES E. WOLVERTON,
Judges of said court.

The petition of Edward H. Chavelle respectfully shows that he is the trustee of Washington Steel & Bolt Company, the bankrupt herein, and that he has been such trustee since the 21st day of March, 1912.

That heretofore, and on the 16th day of October, 1914, two orders were made herein by the judge of the United States District Court for the Western District of Washington, Northern Division, viz: an order modifying an order of Hon. John P. Hoyt, Referee in Bankruptcy, of July 20, 1914, holding all of the bonds issued by the bankrupt null and void—the District Court modifying said order to the extent of holding $10,000 of said bonds valid; and the other an order made by the same referee on the 28th day of July, 1914, directing a sale of the property of the bankrupt estate free and clear from the lien of the mortgage thereon.

That thereafter, and on the 26th day of October, 1914, your petitioner duly appealed from so much of said first mentioned order as held $10,000

of said bonds valid, and The Washington Trust Company, the trustee under the mortgage given to secure said bonds, appealed from the balance of said order, and also appealed from the second mentioned order, and on the same day The Washington Trust Company petitioned for a revision of both said orders.

That all of said appeals and both of said revisions came on for hearing, as one cause, before this court on the 19th day of February, 1915, and all said appeals and revisions were heard on that day. That thereafter, and on the 4th day of October, 1915, this court filed an opinion herein in which it decided the appeals from the first mentioned order, *but did not decide the appeal, nor did it decide the revision, from the last mentioned of said orders—the order directing a sale free and clear.*

Your petitioner presents this, his petition for a rehearing, and respectfully petitions this Honorable Court to grant a rehearing herein upon the following grounds:

I.

That this Honorable Court erred in not deciding the appeal or the revision from the order directing a sale of the property free and clear from the lien of the mortgage thereon.

II.

That this Honorable Court fell into grave error as to what was decided by the Supreme Court of the State of Washington in *Bright v. Offield* (81 Wash. 442; 143 Pac. 159), and, as a consequence thereof, fell into grave error in holding the bonds in question, or any of them, negotiable.

III.

That, regardless of the decision of the Supreme Court of Washington in the *Bright* case, the bonds in question are non-negotiable, and this Honorable Court fell into grave error in holding them, or any of them, negotiable.

In writing the opinion of the court herein, Mr. Justice Ross, after quoting the provision in the bonds relative to the payment of taxes, etc. said:

"It is said that thereby the amount to become due on the bonds was rendered uncertain, and the decision of the Supreme Court of Washington, in the case of Bright v. Offield, 143 Pac. 159, is cited in support of the contention. The decision there made in respect to the promissory note there in question is correctly stated in the 4th subdivision of the syllabus to that case, which is as follows:

" 'A note, secured by a mortgage, provided that if the maker should allow the taxes or any other public rates and assessments on the mortgaged property to become delinquent, or should do any act whereby the value of the mortgaged property should be impaired, or in case any taxes or assessments should be levied against the holder of the note on

account thereof, then on the happening of any of such contingencies the whole amount secured should at once become due and payable, and the mortgagee might collect the debt and foreclose the mortgage and sell the mortgaged property, or so much thereof as should be necessary to satisfy the debts, interest, and costs and all taxes, public rates, or assessments that might be due thereon, etc. *Held*, that by necessary implication the maker was bound to pay any such taxes, the provision being analogous to one authorizing the holder of the note to declare it due at any time he deemed the debt insecure, and destroyed the note's negotiability.' "

In the first place, Mr. Justice Ross was entirely wrong in saying that it is our contention that the provision under discussion rendered the amount to become *due* on the bonds uncertain. That is not our contention. Our contention is that thereby the amount to be *paid* by the maker of the bonds became uncertain. In none of the cases cited upon our brief upon this proposition was there any provision whereby the holder of the security received any additional sum, or where any additional sum became *due* by reason thereof, but all such decisions were based upon the fact that by reason of the provision *the maker might be compelled to pay* a greater or less sum than that primarily specified in the instrument, and that is our contention here.

In the second place, with all due deference to the opinion of Mr. Justice Ross, I am constrained to say that the syllabus in 143 Pac. *does not* correctly state the decision of the Supreme Court of

Washington in that regard. If the court will turn to the opinion in the *Bright* case (at page 447 of 81 Wash.—page 161 of 143 Pac.), it will find that the court quoted the provision there under discussion as follows:

" 'If the maker . . . shall allow the taxes or any other public rates and assessments on the mortgaged property . . . to become delinquent . . . or in case any taxes or assessments shall be levied against the holder . . . on account of this note, . . . then . . . the whole amount herein secured shall at once become due and payable, and the mortgagee, its legal representatives or assigns, may proceed at once to collect these notes and foreclose the mortgage,' etc."

It will be observed that this quotation, as used by the Supreme Court of Washington, leaves out entirely all reference to that part of the provision of the notes, there under discussion, providing for adding to the amount of the recovery the amount of any such unpaid taxes or assessments. Furthermore, in discussing the proposition, Mr. Justice Ellis did not place the decision upon that ground, but upon the ground that because there was an implied promise by the maker to pay such taxes that thereby the amount to be paid by the maker of the note became uncertain, and that, therefore, the note was made non-negotiable.

To prove the correctness of this assertion, I call the attention of the court to the fact that after quoting the provision of the note as above set forth, and

after holding that the provision therein accelerating the time of payment by non-payment of taxes, did not make the note non-negotiable, Mr. Justice Ellis continued:

"There is another phase of this condition of the note, however, which makes the undertaking uncertain in the amount to be paid in case of acceleration of maturity by such delinquency of taxes, * * * The note, by its terms, is, in addition to a promise to pay a certain sum of money, a thinly veiled promise to pay the taxes on the mortgaged property, and not to allow taxes to be levied against the holder on account of the note. It is equivalent to a promise to pay these charges when due. So viewed, the instrument falls directly within the rule announced by the United States Circuit Court in *Farquhar v. Fidelity Insurance Co.*, 8 Fed. Cas., p. 1068, No. 4676, where it is said:

" 'Overlooking the clause touching attorney's commissions, how can it be said that the notes are either unconditional or certain in amount, in view of the stipulation for the payment of taxes or charges in the nature thereof, assessed upon the principal or interest? Liable to taxation as the property and in the hands of the holder (and this is the import of the stipulation); in some places they would probably be free from this charge, while in others they may be subjected to indefinite and varying rates of taxation, so that the amount to be paid by the maker, either before or at the maturity of the notes, would fluctuate according to collateral circumstances, and be dependent upon the domicile of the holder. And of these contemplated charges, or additions to the nominal consideration, the notes themselves indicate no standard of measurement. They could only be ascertained by reference to extrinsic circumstances, and thus the amount to be paid by the maker is left indeterminate and subject to possible contention. Instruments whose consider-

ation is thus fluctuating and indefinite, and which are laden with such embarrassments to their circulation, could not perform the functions, and therefore do not possess the character of negotiable paper.' "

In the opinion in the *Farquhar* case, and immediately preceding the part thereof quoted by Mr. Justice Ellis, the court stated the conditions in the notes there under discussion, as follows:

"The notes, which are the subject of this litigation, are objectionable on this ground. They are secured by mortgage, are for $5,000 each, payable to bearer in ten years, with interest semi-annually, 'together with an attorney's commission of five per cent. for collection, in case suit be instituted hereon, and together with all taxes and charges in the nature thereof that may be levied upon this note or upon the indenture of mortgage accompanying the same, or the principal or interest moneys thereby secured, immediately upon their assessment.' "

Following the above quotation from the opinion in the *Bright* case, Mr. Justice Ellis cited the following cases as holding the same proposition, viz: *Howell v. Todd* (12 Fed. Cas., p. 707, No. 6783); *Walker v. Thompson* (108 Mich. 686, 66 N. W. 584); *Carmody v. Crane* (110 Mich. 508, 68 N. W. 268); and *Wistrand v. Parker* (7 Kan. App. 562, 52 Pac. 59).

In the *Howell* case, the court said:

"The second ground is that the amount to be paid is uncertain, for it provides for the payment, not only of interest which is certain, but also of taxes, the amount of which must necessarily be un-

certain until after they are assessed or imposed according to law. The instrument in question quite certainly is not a negotiable note."

The note in suit in the *Walker* case was as follows:

"$800.00. Paw Paw, Mich., Nov. 24th, A. D. 1892. Five years after date, for value received, I promise to pay to George E. Breck or bearer the principal sum of eight hundred dollars, with interest thereon at the rate of seven per cent. per annum, payable yearly, to-wit, on the 24th day of November in each year until due, and at the rate of seven per cent. per annum, paid annually after due, and to pay all taxes assessed against the real estate and the mortgagee's interest therein, described in the mortgage given to secure this note, until it is paid. The several installments of interest aforesaid, for said period, are further evidenced by five interest notes or coupons, of even date herewith. The payment of this note is secured by mortgage, of even date herewith, on real estate described therein, in Keeler, Van Buren county, Michigan. No. one. Jasper L. Thompson."

The court held that this note was non-negotiable.

In the *Carmody* case, the court said that the note in suit was "in form precisely like that considered in Walker v. Thompson", and in deciding the case said:

"1. While it is true that the mortgagee's interest in land was not, at the date of the making of the note in question, October 20, 1894, subject to assessment for taxation as such, yet the obligation under this note is not limited to such assessments as might in the future be made under existing laws,

but it covers as well assessments which might thereafter be authorized by legislation." The note was held to be non-negotiable.

The note in the *Wistrand* case contained the following provision:

"This note is secured by a mortgage on real estate. This note may become due and payable at once by reason of the failure to comply with the conditions of the accompanying mortgage, which is made a part hereof."

The mortgage provided "If the said party of the first part shall pay said notes, and the interest thereon when due, and shall pay all taxes and assessments levied against said premises before the same become delinquent, then this deed shall become void, and shall be released at the cost of the party of the first part. But should first party fail to pay said notes or interest, or any part thereof, when due, according to the tenor and effect of said notes, or fail to pay all taxes and assessments before the same become delinquent, then all said notes become immediately due and payable at the option of the party of the second part, or the legal holder of such notes, without notice, and shall draw interest at the rate of 12 per cent. per annum from the date of said note until fully paid."

It was held that the notes and the mortgage must be read together, and that, when so read, the notes were non-negotiable by reason of the provision in the mortgage for the payment by the maker of taxes, and that the note would, at the option of the holder, become immediately due and payable if such taxes were not paid as therein provided.

In view of what Mr. Justice Ellis said and quoted in the *Bright* case, and in view of the decisions of

the various courts in the cases cited by him, can this court longer doubt that that decision was based squarely upon the fact that the maker of the note there in question had agreed to pay taxes, if any, in addition to paying the sum for which the note was primarily given?

Following the citation of the above cases, Mr. Justice Ellis said:

"The instrument further provides that 'if the maker . . . shall do any act whereby the value of said mortgaged property shall be impaired,' the whole amount shall at once become due and payable, and the mortgagee may proceed to collect the notes and foreclose the mortgage. This would authorize the holder of the note to proceed to collect the note and foreclose the mortgage upon the doing of any one of an almost infinite variety of things, such as suffering or committing waste, suffering the buildings to burn down without replacing them, suffering a nuisance to be maintained upon the mortgaged or adjacent property, permitting undesirable tenants to occupy the premises, and many other things which might be suggested. It is, in effect, an undertaking to prevent these things, in addition to the payment of money. This provision is closely allied to a provision authorizing the holder of a note to declare it due at any time he may deem the debt insecure. Such provision usually, and we think soundly, is held to destroy the negotiability of the note. *First National Bank v. Bynum*, 84 N. C. 24, 37 Am. Rep. 604; *Smith v. Marland*, 59 Iowa 645, 13 N. W. 852; *Holliday State Bank v. Hoffman*, 85 Kan. 71, 116 Pac. 239, 35 L. R. A. (N .S.) 390."

In each of the cases cited by Mr. Justice Ellis, as above quoted, there was a provision authorizing the holder of the note to collect it if he deemed him-

self insecure, although the time of payment, as fixed in the note, had not yet arrived.

Following the above quotation, Mr. Justice Ellis further said:

"This instrument is a contract in which the maker has undertaken to do many things beside the payment of a sum certain in money. It is not a negotiable promissory note. Rem. & Bal. Code, §3396 *supra.*"

In the opinion herein, Mr. Justice Ross, still discussing the *Bright* case, further says:

"It is manifest that the clause in the promissory note there involved and considered is wholly unlike the clause contained in the bonds here under consideration, which expressly declare that 'all payments upon this bond, both of the principal and interest, shall be made without deduction for any tax or taxes that said Washington Steel & Bolt Company may be required to pay or to retain therefrom by any present or future laws of the United States of America, or of the State of Washington,' and contains the further express covenant and agreement on the part of the obligor 'to pay any and all such tax or taxes,' in effect an express promise to pay both principal and interest of the bonds in full, *without any deduction* on account of any tax or taxes and an express covenant of the mortgagor to itself pay all such taxes."

Was there any provision in the note in the *Bright* case whereby any *deduction was to be made* by reason of unpaid taxes, and didn't the maker of that note *expressly covenant to himself pay all such taxes?*

The bonds in this case, in addition to the pro-

vision quoted by Mr. Justice Ross, contained a recital that they were secured by a mortgages,

"covering and conveying all real property and personal property owned by the said Washington Steel & Bolt Company, and more particularly described in said mortgage, and to which reference is hereby made for the nature and extent of the security and the rights of the holders of these bonds, and the terms and conditions thereof, which is duly recorded in the office of the County Auditor of Snohomish County, State of Washington." (See copy bond, p. 258 of Transcript of Record.)

It will be noted that not only do the bonds mention the mortgage, but they expressly refer the holder thereof to it, its terms and condition. Such reference made the terms, conditions and covenants of the mortgage a part and parcel of each of the bonds issued under it.

Sill v. Pate, 230 Ill. 39; 82 N. E. 356.

Judy v. Warne, 100 N. E. (Ind.) 483.

Strong v. Jackson, 123 Mass. 60; 25 Am. Rep. 19.

Brown v. Tom, 26 S. W. (Tex. Civ. App.) 299.

In each of the foregoing cases the suit was upon a promissory note, negotiable in form, and in each of them some reference was made to some other writing, viz: the *Sill* case recited that another note and a trust deed were deposited as collateral to it; the *Judy* case contained this statement, "Secured by mortgage"; the *Strong* case recited that it was

secured by mortgage; and the *Brown* case recited that the makers thereof had indorsed over, as security, a certain other note. In none of them was any reference made as to the conditions of the writing mentioned, nor was the holder referred to the writing itself. Notwithstanding that fact, however, in each case the court held that the holder of the note, although a holder for value and before maturity, took it subject to all the conditions contained in the writing referred to therein. The case at bar is much stronger than any of those above cited, for the reason that the bonds here under consideration expressly refer the holders thereof to the mortgage "for the nature and extent of the security and the rights of the holders of these bonds, and the terms and conditions thereof."

Assuming the law to be as laid down in the foregoing cases, and there are no decisions to the contrary, let us see what, if any, conditions were contained in the mortgage referred to in the bonds in suit, and which would make them, when construed with the mortgage, non-negotaible. A copy of that mortgage is contained in the Transcript of Record herein, is "Petitioner's Exhibit 39," and is to be found at pages 277-327.

Turning to pages 293-294 thereof, we find that the Washington Steel & Bolt Company covenanted, "that it will keep the buildings and other improvements on said premises in as good condition as the

same are now, and not permit or allow waste upon said premises, and will keep the same free and clear of all taxes, liens or incumbrances which might affect or impair the security of the bondholders, under this Indenture; and that at any time hereafter on demand of the Trustee, it will execute and deliver such further assurances and instruments of title by way of security as shall be necessary to correct any imperfection, which may now exist in the lien created by this Indenture, or to pass by way of security any other acquired title, or interest which the Washington Steel & Bolt Company may hereafter acquire in perfection or enhancement of its own present title, or any additional real or personal property, which may hereafter be acquired or constructed by the Washington Steel & Bolt Company, and that such further assurance and such conveyance of such other acquired property shall be for the purpose of affectuating and confirming the clause of this Indenture purporting to operate upon other acquired property, and in order to extend over the same the lien of this Indenture."

Proceeding to Article I thereof, and on pages 295-296, we find that the Washington Steel & Bolt Company,

"further covenants and agrees at all times diligently to preserve all the rights and privileges now possessed by it, and which may hereafter be granted to or conferred upon it, and at all times to do everything that may be necessary to preserve, maintain or renew its corporate existence and organization, and at all times to preserve and maintain the said Washington Steel & Bolt Company's property, plant or plants hereby conveyed or hereafter acquired and every part thereof, in good repair, working order and condition, and to supply all necessary machinery, tools, stock equipment, appliances and buildings and from time to time to make all needful and proper repairs, renewals, replacements, useful and

proper alterations, additions, betterments and improvements to the end that the value of the security under this Indenture shall never become lessened or impaired."

Article III thereof, pages 296-299 of record, provides that if default is made in any of the covenants contained in said mortgage the Trustee may take possession of the property and conduct the business, etc.

Article IV thereof, pages 299-301 of the record, provides that if default shall be made as to the payment of taxes, or as to any of the covenants or agreements contained in the mortgage, the Trustee may take possession of the property, sell the same, from the proceeds pay all taxes, etc., and apply the balance upon the bonds.

Article V thereof, pages 301-306 of the record, provides that if default shall be made in the interest, in the payment of taxes, or "in respect to any act, promise, stipulation, covenant or agreement herein contained," the Trustee may take and operate the property, as provided in Article III; sell it, as provided in Article IV; or proceed to foreclose the mortgage by suit, and that in the event of sale, either by the Trustee or through foreclosure, the taxes, charges, etc., are to be first paid, and that the balance of the money derived from the sale be distributed among the bondholders, etc.

Reading these covenants into the bonds, as we

have seen they must be read into them, we then have instruments which are, as Mr. Justice Ellis said about the note in the *Bright* case, "a contract in which the maker has undertaken to do many things beside the payment of a sum certain ~~of~~ money." Wherein is it possible to draw any distinction between the note in the *Bright* case and the bonds in this case? I submit that no distinction exists—not even in the provision providing for the payment of taxes out of the proceeds of the sale of the property, although, as hereinbefore pointed out, the Supreme Court of Washington did not base its decision in the *Bright* case upon that provision of the note there in question.

In writing the opinion of the court in this case, Mr. Justice Ross, after quoting from that provision of the bonds in this case whereby the Washington Steel & Bolt Company promises "to pay any and all such tax or taxes"; says that this is "in effect an express promise to pay both principal and interest of the bonds in full, *without any deduction* on account of any tax or taxes and an express covenant of the mortgagor to itself pay all such taxes." It will be noted that Mr. Justice Ross emphasized the words "without any deduction" by underscoring them, thereby, evidently, basing his decision upon the fact that, because the amount of such taxes was not to be deducted from the amount due upon the

bonds, this case differed from the *Bright* case. Mr. Justice Ross, evidently, assumed that the decision in the *Bright* case was based upon the fact that the holder of the note there under discussion was empowered to take advantage of certain lapses of the maker of the note, and to do certain things in the event such lapses occurred. Such, however, was not the ground of the decision in the *Bright* case, but the note in that case was held to be non-negotiable because it was "a contract in which the maker has undertaken to do many things beside the payment of a sum certain in money." Has the maker of these bonds undertaken to do fewer things "beside the payment of a sum certain in money" than had the maker of the note in the *Bright* case?

The Negotiable Instrument Act of the State of Washington was passed in 1899, and both the note in the *Bright* case and the bonds in this case were issued under that act. A copy of so much of that act as is material to the question here discussed is set forth, at length, in the opinion in the *Bright* case, also in the brief of the Trustee in Bankruptcy herein (pages 40-42), and I beg to refer the court thereto, without repeating it here.

When the writer of this petition for a rehearing wrote the brief for the Trustee in Bankruptcy herein, he did not go so thoroughly into a discussion of the decision in the *Bright* case as he has now done

for the reason that, to his mind at least, the decision in that case and the opinion written by Mr. Justice Ellis therein, were so absolutely plain that no possible misunderstanding of what was decided there, or of the ground upon which that decision was based, could be had. He has now attempted to rectify the mistake he then made.

It is quite evident that Mr. Justice Ross considered C. F. Chapin, Meta McElroy, and Thomas Burley holders of bonds "in good faith and for value." Did he overlook the fact that at the time they purchased the bonds from McPhaden they were all stockholders in the Washington Steel & Bolt Company, and that as such they were chargeable with knowledge as to the conditions of the mortgage, and chargeable with knowledge as to how McPhaden acquired the bonds he transferred to them? Attention was specifically called to that fact in the brief for the Trustee in Bankruptcy, page 33, as follows:

"In the first place, Chapin, Mrs. McElroy, and Burley were all stockholders in the Washington Steel & Bolt Company at the time they bought their bonds. (See testimony of Burley, Record, p. 178; testimony of Chapin, Record, p. 216 ; and testimony of Mrs. McElroy, Record, p. 218). Being stockholders, they were bound to know the provisions of the trust deed."

What has heretofore been said in this petition has, as the court has already seen, been upon the

error claimed under II of the statement of errors herein, viz: misconstruction of what was decided by the Supreme Court of Washington in the *Bright* case. The error claimed under III of the statement of errors is, however, covered by the cases cited in the discussion under II of that statement inasmuch as they show the law to be that an instrument, otherwise negotiable, is made non-negotiable by the insertion therein of a promise by the maker to pay any taxes that may be levied upon the interest of the holder of the instrument, in addition to the payment of the sum primarily provided for in the instrument, and that, too, entirely irrespective of the decision in the *Bright* case.

Your petitioner begs leave to refer to, and make a part of this petition for a rehearing, his brief heretofore filed herein, as fully as if the same was incorporated at length herein, and asks to have the arguments therein considered as fully upon the decision of this petition as if it was so incorporated herein at length.

Wherefore, your petitioner prays that a rehearing be granted him herein, and he will ever pray.

EDWARD H. CHAVELLE,
Petitioner.

J. W. RUSSELL,
Petitioner's Attorney.

State of Washington, }
County of King. } ss.

Edward H. Chavelle, being duly sworn, deposes and says that he is the petitioner in the foregoing petition named; that he has read the foregoing petition, knows the contents thereof, and believes the same to be true.

Subscribed and sworn to before me this 30th day of October, 1915.

EDWARD H. CHAVELLE,

B. T. WOODS, JR.

Notary Public in and for the State of Washington, residing at Seattle.

(L. S.)

State of Washington, }
County of King. } ss.

I, Joel W. Russell, attorney for the petitioner above named, and counsel for him herein, do hereby certify that, in my judgment, said petition for a rehearing herein is well founded, and further certify that it is not interposed for delay.

J. W. RUSSELL.